



**STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS**

DRAFT

Date Amended:	04/20/05	Bill No:	AB 1612
Tax:	Cigarette Pollution and Litter Prevention Fee	Author:	Pavley
Related Bills:	SB 942 (Chesbro)		

BILL SUMMARY

This bill would require a manufacturer of cigarettes to pay a cigarette pollution and litter prevention fee for each package of cigarettes distributed for sale to consumers in the state, as specified.

Summary of Amendments

Since the previous analysis, this bill was amended to specify a fee rate of ten cents (\$0.10) for every package of cigarettes distributed, allow the Board to collect the fee pursuant to the Fee Collection Procedures Law, and to make other clarifying changes.

ANALYSIS

Current Law

Pursuant to Revenue and Taxation Code Section 30101 (Cigarette and Tobacco Products Tax Law), an excise tax of 6 mills (or 12 cents per package of 20) is imposed on each cigarette distributed. In addition, Sections 30123 and 30131.2 impose a surtax of 12 1/2 mills (25 cents per package of 20) and 25 mills (50 cents per package of 20), respectively, on each cigarette distributed. The current total tax on cigarettes is 43 1/2 mills per cigarette (87 cents per package of 20).

Of the 87 cent excise tax imposed on a package of 20 cigarettes, 2 cents is deposited into the Breast Cancer Fund, 10 cents into the General Fund, 25 cents into the Cigarette and Tobacco Products Surtax Fund, and 50 cents into the California Children and Families First Trust Fund (CCFF Trust Fund).

Proposed Law

This bill would add Division 12.8 (commencing with Section 19000) to the Public Resources Code as the Cigarette Pollution and Litter Prevention Act of 2005 (Act).

CIGARETTE POLLUTION AND LITTER PREVENTION FEE

This bill would require a manufacturer to pay, on July 1, 2006, and on or before July 1 annually, a cigarette pollution and litter prevention fee of ten cents (\$0.10) for each

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package of cigarettes distributed for sale to consumers in the state during the previous calendar year, as reported to the Board. The Board would be required to notify each manufacturer of the amount of the cigarette pollution and litter prevention fee due.

The Board would collect the cigarette pollution and litter prevention fee pursuant to the Fee Collection Procedures Law (Part 30 (commencing with Section 55001) of Division 2 of the Revenue and Taxation Code). The Fee Collection Procedures Law contains "generic" administrative provisions for the administration and collection of fee programs to be administered by the Board. The Fee Collection Procedures Law was added to the Revenue and Taxation Code to allow bills establishing a new fee to reference this law, thereby only requiring a minimal number of sections within the bill to provide the necessary administrative provisions. Among other things, the Fee Collection Procedures Law includes collection, reporting, refund and appeals provisions, as well as providing the Board the authority to adopt regulations relating to the administration and enforcement of the Fee Collection Procedures Law.

This bill would also authorize the Board to pay refunds to manufacturers for any overpayments of the fee from the Cigarette Pollution and Litter Prevention Fund.

FINANCIAL PROVISIONS

The Board would deposit all fees collected into the Cigarette Pollution and Litter Prevention Fund (Fund), which this bill would create in the State Treasury. The revenues in the Fund would be available for expenditure by the Department of Conservation (Department) and the State Department of Health Services (DHS), upon appropriation by the Legislature, for all of the following purposes and programs:

- Not less than 50 percent of the revenues annually deposited in the Fund would be expended by the Department to provide funds to cities, counties, and other public agencies to offset the costs of programs for the prevention and cleanup of cigarette related pollution and litter.
- Not less than 25 percent of the revenues annually deposited in the Fund would be expended by the DHS, in consultation with the Department and the State Water Resources Control Board, to develop and implement public education programs by public agencies and nonprofit organizations aimed at reducing the source of cigarette related litter and pollution and the resulting public cost.
- Not less than 5 percent of the revenues annually deposited in the Fund would be expended by the DHS for programs to assist individuals to access and utilize smoking cessation services.
- Not less than 5 percent of the revenues annually deposited in the Fund would be expended to develop and implement public education, media advertising, and outreach programs aimed at preventing individuals from starting to smoke.
- Not less than 5 percent of the revenues annually deposited in the Fund would be expended to develop and implement effective community interventions aimed at reducing the harm caused by cigarettes.

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- Not more than 2 percent of the revenues annually deposited in the Fund would be expended by the board for the cost of collecting this fee.
- Not more than 2.5 percent of the revenues annually deposited in the Fund would be expended by the Department of Conservation to administer the Act.
- Not more than 2.5 percent of the revenues annually deposited in the Fund would be expended by the DHS to administer the Act.

DEFINITIONS

This bill would define the following terms:

- "Board" – the State Board of Equalization.
- "Cigarette" – has the same meaning as defined in Section 30003 of the Cigarette and Tobacco Products Tax Law.
- "Cigarette package" - an individual packet, box or other container in which retail sales of cigarettes are normally made or intended to be made. "Package" does not include a container that is a carton, case, bale or box and that contains smaller packaging units of cigarettes.
- "Manufacturer" - a person who manufactures a cigarette.

The bill would become effective January 1, 2006.

COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by the American Lung Association and Californians Against Waste and is intended to establish a fee level that is sufficient to offset cigarettes fair share of current and future public agency (taxpayer) costs of pollution and litter cleanup, along with efforts to prevent it.
2. **The April 12, 2005, amendments** specify a fee rate of ten cents (\$0.10) for every package of cigarettes distributed, allow the Board to collect the fee pursuant to the Fee Collection Procedures Law, and make other clarifying changes.
3. **Administrative concerns.** The April 12, 2005, amendments addressed many of the concerns described in the prior Board staff analysis. Board staff is continuing to work with the sponsor of this measure and the author's office to address any remaining concerns that include, but are not limited to, the following:
 - Currently, this measure is silent as to how the Board would obtain the information necessary to compute the fee owed by a manufacturer. It is suggested that the bill include provisions to require distributors to report the number of packages of cigarettes stamped by a manufacturer for purposes of imposing the appropriate fee upon manufacturers.
 - Collecting the proposed fee from foreign manufacturers would be difficult, if not impossible, if that manufacturer does not have nexus within this state. It is suggested that the fee also be imposed upon importers of cigarettes sold in this state and that the term importer be defined. The term "importer" should have the

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same meaning as that term is defined in Section 30019 of the Revenue and Taxation Code, which provides that an importer is any purchaser for resale in the United States of cigarettes manufactured outside of the United States.

- This bill would require a manufacturer to pay the fee on or before July 1, 2006, for each package of cigarettes distributed for sale to consumers in the state during the previous calendar quarter. Therefore, the amount of the fee due on or before July 1, 2006 would be based on cigarettes distributed during the period of January 1, 2005 through December 31, 2005. If this bill were signed into law, the Board would not have sufficient information to bill a manufacturer for the fee due on or before July 1, 2006 since the Board currently does not capture the number of cigarettes distributed in this state by manufacturer.
- 4. **This bill should contain a specific appropriation to the Board.** This bill proposes a fee to be imposed commencing on July 1, 2006. However, implementation of the proposed fee program would begin prior to July 1, 2006, which is in the middle of the state's fiscal year. In order to begin to develop reporting forms, hire appropriate staff, and develop computer programs, an adequate appropriation would be required to cover the Board's administrative start-up costs that would not already be identified in the Board's 2005-06 budget.
- 5. **Cost cap could be problematic.** This bill would create a new fee program to be administered by the Board. The provisions in this bill provide that reimbursement to the Board to cover the cost of collecting the fee would be limited to an amount not to exceed 2 percent of funds generated. Based on the current revenue estimate of \$120 million annually, the Board would be reimbursed for costs up to \$2.4 million annually. Since the implementation and administration costs have not yet been estimated by the Board, it is not known at this time if the cost cap would provide the Board with sufficient funding to administer the fee.
- 6. **This bill could increase state and local sales and use tax revenues.** In order to be reimbursed for the fee, cigarette manufacturers may increase the price of cigarettes, which would be reflected in the retail sales price of cigarettes sold to the ultimate consumer.

Sales and use tax is due based on the gross receipts or sales price of tangible personal property in this state. Since the proposed fee would not be specifically excluded from gross receipts or sales price, it would be included in the amount on which sales or use tax is computed.

- 7. **Would the proposed cigarette pollution and litter prevention fee increase evasion?** Tax evasion is one of the major areas that can reduce state revenues from cigarettes and tobacco products. Board staff recently estimated that cigarette tax evasion in California was running at a rate of approximately \$292 million annually. That estimate was only for evasion of cigarette taxes, and did not include associated evasion of other taxes, such as sales and use, tobacco products or income taxes.

A key premise in the Board's research is that both cigarette consumption and cigarette tax evasion are highly correlated to product prices and excise tax rates.

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For example, two major events that occurred since November 1998 dramatically increased California excise taxes as well as cigarette prices excluding taxes: Proposition 10 and the Tobacco Master Settlement Agreement made between states and tobacco manufacturers (tobacco settlement). Together, these two developments, when coupled with typical wholesaler and retailer distribution margins, have increased average prices of cigarettes to California consumers by about 50 percent in relation to early November 1998 prices. It was estimated that the impacts of Proposition 10 and the tobacco settlement more than doubled cigarette tax evasion in California.

This bill would impose an unspecified fee on each person who manufactures a cigarette, as specified. This fee could result in an increase in the selling price of cigarettes, which based on the Board's findings when developing the impacts of Proposition 10 and the tobacco settlement, could cause a correlated increase in tax evasion.

8. **Legal challenges of any new fee program might be made on the grounds that the fee is a tax.** In July 1997, the California Supreme Court held in *Sinclair Paint Company v. State Board of Equalization* (1997) 15 Cal.4th 866 that the Childhood Lead Poisoning Prevention Act of 1991 imposed bona fide regulatory fees and not taxes requiring a two-thirds vote of the Legislature under Proposition 13. In summary, the Court found that while the Act did not directly regulate by conferring a specific benefit on, or granting a privilege to, those who pay the fee, it nevertheless imposed regulatory fees under the police power by requiring manufacturers and others whose products have exposed children to lead contamination to bear a fair share of the cost of mitigating those products' adverse health effects.

Although this measure has been keyed by the Legislative Counsel as a majority vote bill, opponents of this measure might question whether the fees imposed are in legal effect "taxes" required to be enacted by a two-thirds vote of the Legislature.

9. **Related legislation.** Senate Bill 942 (Chesbro) would require each manufacturer of cigarettes to pay a cigarette pollution and litter prevention fee for each package of cigarettes sold by that manufacturer in California, as specified. That bill requires the Department to notify each manufacturer of the amount of fee due and would authorize the Department to collect the fees pursuant to the Fee Collection Procedures Law. That bill also authorizes the Department to contract with the Board or another party for collection of the fees due.

COST ESTIMATE

The Board would incur non-absorbable costs to adequately develop and administer a new fee program. These costs would include registering fee payers, developing computer programs, mailing and processing determinations and payments, carrying out compliance and audit efforts to ensure proper reporting, developing regulations, training staff, answering inquiries from the public and investigative efforts. A cost estimate of this workload is pending.

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REVENUE ESTIMATE**Background, Methodology, and Assumptions**

Based on statistics compiled from the Board's Excise Taxes Division, cigarette reports, the total number of cigarette packs consumed in 2003-04 was 1.2 billion packs. Based on the proposed fee of \$0.10 per package of cigarettes, the revenue is estimated to be \$120 million ($\$0.10 \text{ per pack} \times 1.2 \text{ billion packs} = \120 million).

Sales and Use Tax Impacts

We assume that all cigarette tax increases are passed on to consumers.

Revenue Summary

It is estimated that this bill would generate about \$120 million in annual revenues for the Cigarette Pollution and Litter Prevention Fund, which this bill would create in the State Treasury.

In addition, this fee would generate \$9.5 million in State and Local sales and use tax as follows:

State (5.25%)	\$ 6.3 million
Local (2.0%)	2.4 million
District (.67%)	<u>0.8</u> million
Total	<u>\$9.5</u> million

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